

Message Text

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C O N F I D E N T I A L SECTION 01 OF 03 PARIS 09473

PASS TREASURY

LIMDIS GREENBACK

E. O. 11652: GDS

TAGS: EFIN

SUBJECT: CAPITAL FLOWS AND OFFICIAL RESERVES IN FRANCE

1. SUMMARY: "ORGANIZED BORROWING" ABROAD BY ENTITIES THAT ARE PART OF THE "TREASURY CIRCUIT" IN THE DOMESTIC CAPITAL MARKET--E.G., EDF/GDF, CAISSE DES AUTOROUTES, ETC.--PLUS EXPORT RECEIPTS FUNNELED THROUGH SWITZERLAND BY MAJOR FRENCH EXPORTERS--E.G., RENAULT-AND CERTAIN CAPITAL INFLOWS ASSOCIATED WITH THE DOMESTIC BOND MARKET COMPRISE A POOL OF FUNDS WHICH ENABLES THE MOF TO SUPPLEMENT OFFICIAL FOREIGN EXCHANGE RESERVES. THE MODE OF OPERATION VARIES ACCORDING TO THE INSTITUTIONS INVOLVED, BUT THE KEY FEATURE IS THAT THE MOF TO SOME OR TO A CONSIDERABLE EXTENT CAN INFLUENCE THE TIMING OF SUCH FLOWS WITH THE OBJECTIVE OF SUPPLEMENTING OR MASKING OFFICIAL FOREIGN EXCHANGE MARKET INTERVENTION. SUCH TRANSACTIONS HAVE ONE INVARIABLE COMMON DENOMINATOR: THEY ARE INDISTINGUISHABLE FROM THE FLUX OF ONGOING PAYMENTS AND RECEIPTS AND TAKE PLACE IN THE FOREIGN EXCHANGE MARKET ON EXACTLY THE SAME BASIS AS OTHER COMPARABLE TRANSACTIONS. THUS, WHETHER THEY INCREASE

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OFFICIAL RESERVES OR NOT IS DETERMINED SOLELY BY WHETHER THE BANK OF FRANCE IS A NET PURCHASER OF FOREIGN EXCHANGE AT THE TIME SUCH TRANSACTIONS ARE UNDERTAKEN. THEY CAN, OF COURSE, REDUCE AN OTHERWISE LARGER REDUCTION OF OFFICIAL RESERVES IF SUCH OPERATIONS OCCUR AT A TIME WHEN THE BANK OF FRANCE IS A NET SELLER OF FOREIGN EXCHANGE. THESE OPERATIONS NEITHER OCCUR BY

NOR THROUGH THE ACTIVITIES OF THE EXCHANGE STABILIZATION FUND OF THE MOF WHICH DOES NOT ENGAGE IN FOREIGN EXCHANGE MARKET OPERATIONS EXCEPT THROUGH THE BANK OF FRANCE OR OTHER MONETARY AUTHORITIES. THE TERM "HIDDEN RESERVES" IS QUIE MISLEADING SINCE IT IMPLIES FUNDS SET ASIDE OR ON HAND, WHILE THE KEY CHARACTERISTIC OF SUCH OPERATIONS, AS NOTED ABOVE, IS THE ABILITY TO INFLUENCE TO SOME EXTENT THE TIMING AND THE VOLUME OF THE FLOW OF A CERTAIN SET OF TRANSACTIONS, BASED ALMOST ENTIRELY ON THE ROLE OF THE MOF IN THE OPERATIONS OF THE DOMESTIC FRENCH CAPITAL MARKET. END SUMMARY

2. "ORGANIZED BORROWING" BY ENTITIES WHICH ARE PART OF THE "TREASURY CIRCUIT" IN THE CAPITAL MARKET ARE BOTH THE LARGEST AND THE MOST OBVIOUS SOURCE OF CAPITAL INFLOWS THAT CAN BE TIMED AND COORDINATED WITH FOREIGN EXCHANGE POLICY OBJECTIVES. THE PRECISION OF SUCH OPERATIONS DEPENDS UPON THE NATURE OF THE ENTITY UNDERTAKING FOREIGN BORROWING. FOR EXAMPLE, THE EDF/GDF BORROWINGS ARE FOR BACK-UP CREDITS FOR ITS OPERATIONS IN THE U.S. COMMERCIAL PAPER MARKET. AS SUCH, THESE BORROWINGS REPRESENT A MORE OR LESS CONTINUOUS FLOAT WHICH CANNOT BE FINE TUNED IN TERMS OF WEEK-TO-WEEK FOREIGN EXCHANGE MARKET REQUIREMENTS. ON THE OTHER HAND, BORROWINGS BY ENTITIES SUCH AS CAISSE DES AUTOMOBILES, CAISSE DES TELECOMMUNICATION, AND VARIOUS

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PUBLICLY OWNED BANKS, ETC., CAN BE TIMED BROADLY; AND THE DRAWDOWN OF THE FUNDS CAN BE COORDINATED WITH OFFICIAL FOREIGN EXCHANGE MARKET INTERVENTION REQUIREMENTS. IN ANY CASE, THE MARKET MECHANISM IS EXACTLY THE SAME AS FOR ANY OTHER RESIDENT EXTERNAL BORROWING. THERE ARE NO SPECIAL ACCOUNTS INVOLVED. THE TOTAL OF SUCH BORROWINGS VARIES; BUT IN RECENT YEARS IT HAS BEEN BETWEEN 16 TO 18 BILLION FRANCS, AN AMOUNT ROUGHLY EQUAL TO THE EXTENSION OF MEDIUM- AND LONG-TERM EXPORT CREDITS BY THE GOF. THIS SUGGESTS THAT SUCH BORROWINGS ALSO ARE DESIGNED TO OFFSET FRENCH MEDIUM- AND LONG-TERM

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EXPORT CREDIT SO AS TO AVOID THE LONG-TERM CAPITAL
OUTFLOW WHICH WOULD OTHERWISE RESULT FROM AN INCREASE
IN SUCH EXPORT CREDITS.

3. MANY MAJOR FRENCH EXPORTERS RECEIVE PAYMENTS FOR
EXPORTS THROUGH FINANCE COMPANIES IN SWITZERLAND--E.G.,
RENAULT. THUS THERE IS AT ANY TIME A SUBSTANTIAL
FLOAT OF NON-RESIDENT FRANC COLLECTIONS WHICH ARE TO
SOME EXTENT SUBJECT TO INFLUENCE EITHER DIRECTLY OR
INDIRECTLY THROUGH CREDIT POLICY. FOR EXAMPLE, IF
RENAULT CAN BORROW RELATIVELY EASILY DOMESTICALLY,
ITS FLOAT IN RECEIVABLES HELD IN SWITZERLAND BY
RENAULT FINANCE COULD INCREASE; AND THE REVERSE WOULD
OCCUR IF RENAULT FOUND DOMESTIC BORROWING MORE COSTLY
OR DIFFICULT. SUCH OPERATIONS BY MAJOR FRENCH EXOORTERS
ARE THE SOURCE ON THE SUPPLY SIDE OF EUROFRANCS. UNLIKE
FOREIGN BORROWING, RECEIVABLES HELD ABROAD BY FRENCH
RESIDENTS CANNOT INCREASE TOTAL AVAILABLE FUNDS: BUT
THEY CERTAINLY CAN INFLUENCE THE FLOW OF SUCH FUNDS AND
THEREBY AFFECT THE FOREIGN EXCHANGE MARKET BOTH DIRECTLY
AND INDIRECTLY THROUGH THE EUROFRANC MARKET.

4. THE CAISSE DES DEPOTS ET CONSIGNATIONS IS A
GOVERNMENT FINANCIAL INSTITUTION THAT HOLDS AT ANY
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ONE TIME ABOUT 30 PERCENT OF ALL FRENCH FRANC BONDS
OUTSTANDING. BASED ON THE MANDATORY DEPOSITS OF THE
NATIONAL SAVINGS BANK SYSTEM, SOCIAL SECURITY ACCOUNTS,
OTHER TRUST FUNDS, CERTAIN GOVERNMENT ACCOUNTS, AND
POSTAL SAVINGS, IT IS BY FAR THE LARGEST FINANCIAL
INSTITUTION IN FRANCE AND A DOMINANT ELEMENT IN THE
FRENCH CAPITAL MARKET. WHEN THE GOF FOR BALANCE OF
PAYMENTS AND FOREIGN EXCHANGE POLICY REASONS RAISES

INTEREST RATES, THE CAISSE DES DEPOTS ET CONSIGNATIONS HAS SCOPE FOR SALES OF FRENCH FRANC BONDS TO FOREIGNERS, PARTICULARLY ON THE SECONDARY MARKET. SINCE THE CAISSE IS PREPARED TO BUY OR SELL FRENCH FRANC BONDS AT ANY TIME, THIS PROVIDES THE FOREIGN INVESTOR SOME ASSURANCE IN TERMS OF HIS FOREIGN EXCHANGE RISK. THE ABILITY OF THE CAISSE TO CONDUCT SUCH OPERATIONS, AS NOTED, DEPENDS UPON GOF MONETARY POLICY, THE WILLINGNESS OF THE CAISSE TO SELL FROM ITS PORTFOLIO, AND, OF COURSE, UPON THE WILLINGNESS OF NON-RESIDENTS TO PURCHASE SUCH SECURITIES. NEVERTHELESS, THIS MECHANISM DOES PROVIDE A MEANS OF ATTRACTING FOREIGN CAPITAL ON A SELECTIVE BASIS WHICH IS STRONGLY INFLUENCED BY GOF MONETARY AUTHORITIES.

5. ALL OTHER OPERATIONS--SUCH AS CHANGES IN NET FOREIGN BANK ASSET/LIABILITIES, COMMERCIAL BANK FOREIGN EXCHANGE OPERATIONS, ETC.--WHILE NATURALLY PLAYING A PART IN FINANCING AN OVERALL PAYMENTS DEFICIT ARE NOT PART OF THE "TREASURY CIRCUIT" AND HENCE NOT A PART OF THE SYSTEM DESCRIBED ABOVE.

6. THE FUNCTIONS OF THE EXCHANGE STABILIZATION FUND OF THE MOF ARE ALMOST WHOLLY RELATED TO GOVERNMENT-TO-GOVERNMENT OR CENTRAL BANK-TO-CENTRAL BANK TRANSACTIONS, CONFIDENTIAL

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INCLUDING THE GOF POSITION IN THE IMF AND SPECIAL DRAWING RIGHTS. SINCE SUCH OPERATIONS ARE NOT FOREIGN EXCHANGE MARKET TRANSACTIONS, THEY COULD HARDLY BE USED TO INFLUENCE THE EXCHANGE RATE IN THE FOREIGN EXCHANGE MARKET. THE OTHER OPERATIONS OF THIS FUND INCLUDE: (1) FINANCIAL TRANSACTIONS FOR LARGE MILITARY SALES AND (2) SPECIAL DEPOSITS, SUCH AS THE 500 MILLION DOLLAR DEPOSIT BY THE GOVERNMENT OF IRAN RELATED TO DEVELOPMENT PROJECTS UNDERTAKEN BY FRENCH FIRMS, AND (3) CERTAIN GOVERNMENT-TO-GOVERNMENT PAYMENTS. AGAIN SUCH TRANSACTIONS VERY RARELY GO THROUGH THE FOREIGN EXCHANGE MARKET AS SUCH. THESE TRANSACTIONS GO FROM THE MOF EXCHANGE STABILIZATION FUND THROUGH THE BANK OF FRANCE TO THE OTHER CENTRAL BANKS OR MONETARY AUTHORITIES INVOLVED IN THE TRANSACTION. CONSEQUENTLY, THEY ARE NOT RELEVANT TO THE SYSTEM DESCRIBED ABOVE WHICH IS DESIGNED PRECISELY TO INFLUENCE THE RATE OF EXCHANGE OF THE FRANC BY TRANSACTIONS THAT TAKE PLACE IN THE FOREIGN EXCHANGE MARKET.

7. THE VARIOUS SWAP AGREEMENTS OF THE BANK OF FRANCE, INCLUDING ITS PERIODIC BORROWINGS FROM THE BUNDESBANK, ALSO ARE NOT A PART OF THE SYSTEM DESCRIBED ABOVE. A

SWAP OBVIOUSLY AFFECTS THE AMOUNT OF OFFICIAL FUNDS
AVAILABLE FOR INTERVENTION; BUT SUCH FUNDS ENTER THE
FOREIGN EXCHANGE MARKET ONLY AS THE RESULT OF A
SUBSEQUENT CENTRAL BANK TRANSACTION, NOT A RESULT OF THE

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SWAP ITSELF. THE BANK OF FRANCE IS, OF COURSE, AWARE
OF THE ONGOING AND PROPOSED "TREASURY CORRESPONDENT"
AND OTHER MOF CONTROLLED FOREIGN EXCHANGE TRANSACTIONS
AND COORDINATES IT MARKET INTERVENTION ACCORDINGLY.
FOR EXAMPLE, THE BANK OF FRANCE HAS BEEN KNOWN TO INTER-
VENE IN THE OPPOSITE DIRECTION OF THE "TREASURY CIRCUIT"
TRANSACTIONS IN ORDER TO WORK ON FOREX MARKET PSYCHOLOGY
WHICH GENERALLY IS AWARE OF OFFICIAL INTERVENTION BUT
WHICH HAS NO WAY OF IDENTIFYING THE OTHERWISE QUITE
ORDINARY APPEARANCE OF THE FOREIGN EXCHANGE TRANSACTIONS
OF THE "TREASURY CIRCUIT" WHOSE MEMBERS ARE, AFTER ALL,
ALSO FOREIGN EXCHANGE MARKET CUSTOMERS PLACING ORDERS
ON THE SAME BASIS AS ANY OTHER CUSTOMER. AS NOTED,
THE SYSTEM EXISTS AND WORKS THE WAY IT DOES BECAUSE
IT IS A REFLECTION OF THE ROLE OF THE MOF AND THE
"TREASURY CORRESPONDENTS" IN THE FRENCH CAPITAL MARKET.
IT IS, THUS, AN ADAPTATION OF WELL-ESTABLISHED DOMESTIC
FINANCIAL AND INSTITUTIONAL RELATIONSHIPS DESIGNED TO
INFLUENCE TO SOME EXTENT THE VOLUME AND TIMING OF A
CERTAIN SEGMENT OF THE EXTERNAL TRANSACTIONS OF THE
FRENCH CAPITAL MARKET.

8. THE ABOVE INVOLVES SENSITIVE SOURCES AND IN NO

CASE SHOULD BE DIVULGED OUTSIDE USG.

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